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## TELEPHONE SYSTEMS IN THE UNITED STATES AND JAPAN: DIFFERING REGULATORY REGIMES, DIFFERING SOCIETIES

STEVEN M. SPAETH\*

### INTRODUCTION

New technology is revolutionizing all industries, but possibly none more than telecommunications. All over the world, countries are reforming their telecommunications regulations to adapt to this revolution. In the United States, the break-up of the American Telephone and Telegraph Company ("AT&T")<sup>1</sup> has been discussed extensively.<sup>2</sup> The privatization of British Telecom in the United Kingdom has also received a great deal of attention.<sup>3</sup> In addition, the Member States of the European Economic Community are in the process of adopting new telecommunications regulations.<sup>4</sup>

On April 1, 1985, Japan also privatized its telecommunications industry and opened it up to competition.<sup>5</sup> After this transformation, and five years of regulating a private telecommunications company, the Japanese Ministry of Posts

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The views expressed are those of the author and not necessarily those of the Commission. The Author would like to thank Professor Phillip Martin of Northwestern University for his helpful comments during the early stages of this Article.

1. *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1982) ("*Modified Final Judgment*" or "*MFJ*").

2. Hillman, *Telecommunications Regulation: Martyrdom of the Regulated Monopolist*, 79 NW. U.L. REV. 1183 (1985).

3. Bhattacharyya & Laughhunn, *Price Cap Regulation: Can We Learn From the British Telecom Experience?*, 120 PUB. UTIL. FORT. 20 (Oct. 15, 1987).

4. See *Green Paper on the Development of the Common Market for Telecommunications Services and Equipment*, COM(87)290 final (Brussels, June 30, 1987); *Implementing the Green Paper on the Development of the Common Market for Telecommunications Services and Equipment*, COM(88)48 final (Brussels, Feb. 9, 1988). For a description of the *Green Paper*, see Comment, *A Comparative Study of the Regulatory Treatment of Enhanced Services in the United States and the European Community*, 9 NW. J. INT'L L. & BUS. 415 (1988).

5. Nippon Denshin Denwa Kabushikigaisha Ho ("Nippon Telegraph and Telephone Company Act") (Law No. 85, 1984) [hereinafter *NTT Act*]; *Denki Tsushin Jigyo Ho* ("Electric Telecommunication Business Act") (Law No. 86, 1985) [hereinafter *Telecommunications Act*]; *Nippon Denshin Denwa Kabushiki gaisha Ho oyobi Denki Tsushin Jigyo Ho shiko ni tomonau Kansei Horitsu no seibi to ni kansuru Horitsu* ("Act Concerning the Adjustment of the Relating Acts Pursuant to the Enforcement of The Nippon Telegraph and Telephone Company Act and Electric Telecommunication Act") (Law No. 87, 1984) [hereinafter *Enforcement Act*]. *DOING BUSINESS IN JAPAN, STATUTE VOLUME*, app. 1A, at 62-65 (Z. Kitagawa ed. 1990).

For a good summary of the new telecommunications laws, see Masuda, *Japanese Telecommunications Takes on a Brand New Look*, TELEPHONY 42-45, 81 (Jan. 28, 1985); Okuyama, *Stiff Competition Seen in Japan's Telecommunications Industry*, BUSINESS JAPAN 45 (June 1987); Comment, *Reform of Japanese Telecommunications Law: Panacea or Placebo*, 8 NW. J. INT'L L. & BUS. 145, 164-68 (1987); Note, *Dialing for Foreign Telecommunications Market Access: Is the United States Getting a Busy Signal from Japan?*, 20 VAND. J. TRANSNAT'L L. 495, 509-14 (1987).

and Telecommunications ("MPT") has started to deal with regulatory problems similar to those faced by the United States Federal Communications Commission ("FCC"). Comparing the way the United States and Japan handle these problems provides an interesting insight into their cultures as a whole. This Article provides this comparison, which ultimately reveals that the Japanese tolerate greater governmental authority than Americans.

Section I briefly surveys the telecommunications industry, and discusses how new technology has affected the industry, and its regulation in general. Section II examines how Japan and the United States have reformed their telecommunications regulations to adapt to this new technology. Section III focuses on three specific regulatory problems common to Japan and the United States, and discusses how both countries have responded to these issues. The conclusion explores the relevance of telecommunications regulation to the understanding of society as a whole.

### I. REGULATION OF TELECOMMUNICATIONS

Until very recently, all local and long distance telephone service was provided through a network of telephone wires stretching across the country. This network was very expensive to build initially, but once the network was in place, new telephones could be added inexpensively. Therefore, the more telephones connected to the network, the cheaper it was for each telephone customer.<sup>6</sup> In other words, the telephone industry had large "economies of scale."<sup>7</sup> Consequently, when given a choice between one telephone network acting as a monopoly and several acting in competition, consumers would prefer the monopoly because they would benefit from economies of scale.<sup>8</sup> In economics this is known as a natural monopoly.<sup>9</sup>

However, even though a natural monopoly has the potential to serve consumers better than several competing firms, there is no incentive to do so. Unrestrained monopolies have the power to artificially limit the availability of telephone service, raise telephone rates, and earn excessive profits.<sup>10</sup> Thus, some government regulation is necessary to prevent excessive rates and profits.<sup>11</sup> Both local and long distance telephone service were natural monopolies until recently. By the early 1960s, microwave technology had developed to a point where long distance service no longer required wires, and this technology was

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6. W. BAUMOL & A. BLINDER, *ECONOMICS: PRINCIPLES AND POLICY* 472 (1982).

7. J. BONBRIGHT, *PRINCIPLES OF PUBLIC UTILITY RATES* 10-17 (1961); W. BAUMOL & A. BLINDER, *supra* note 6, at 472, 808.

8. W. BAUMOL & A. BLINDER, *supra* note 6, at 500-01.

9. Natural monopolies themselves have been the subject of a great deal of literature. For a small but excellent sample of this literature, see J. BONBRIGHT, *supra* note 7, at 10-17; A. KAHN, *THE ECONOMICS OF REGULATION* (1971); B. SCHWARTZ, J. FLYNN, H. FIRST, *FREE ENTERPRISE AND ECONOMIC ORGANIZATION: GOVERNMENT REGULATION* 68-71 (6th ed. 1985); W. BAUMOL & A. BLINDER, *supra* note 6, at 497-503.

10. J. BONBRIGHT, *supra* note 7, at 10-17; W. BAUMOL & A. BLINDER, *supra* note 6, at 497.

11. W. BAUMOL & A. BLINDER, *supra* note 6, at 497, 808.

beginning to be introduced in the United States and Japanese telecommunications markets.<sup>12</sup> Microwave technology removed the natural monopoly characteristics from long distance service, making competition possible.<sup>13</sup> These new market conditions prompted Japan and the United States to adapt their regulatory systems to modern technology.

## II. ADAPTATION TO NEW MARKET CONDITIONS

### A. Japan

The telephone was introduced to Japan in 1877.<sup>14</sup> The debate over whether the telecommunications monopoly should be owned by the government or the private sector lasted thirteen years.<sup>15</sup> On one side of the debate were members of the business community who supported private ownership because they wanted an opportunity to enter the industry.<sup>16</sup> In addition, the Ministry of Finance supported privatization because it did not want the government to bear the large costs of initial investment.<sup>17</sup> Other governmental ministries, however, offered several arguments in favor of government ownership. First, the telegraph system was already a government monopoly owned and operated by the Ministry of Technology.<sup>18</sup> Second, the police had been using the telephone in law enforcement during these debates, and a government monopoly could better maintain security.<sup>19</sup> Third, the government could more easily extend telephone service to rural areas.<sup>20</sup> Finally, most major industrialized countries used the government monopoly model.<sup>21</sup> These arguments prevailed, and in 1890, the Ministry of Communications started operating the telephone monopoly.<sup>22</sup>

In 1948, General Douglas MacArthur, as the Supreme Commander for the Allied Powers ("SCAP"),<sup>23</sup> ordered the Japanese government to reorganize the telephone monopoly as a *kosha*, or "public company," in an attempt to reform

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12. Allocation of Microwave Frequencies Above 890 Mc., 27 F.C.C. 359 (1959), *aff'd on rehearing*, 29 F.C.C. 825 (1960); Hillman, *supra* note 2, at 1187; Ito, *Recent Trends in Telecommunications Regulations and Markets in Japan*, 25 JURIMETRICS J. 70, 74 (1984).

13. *Modified Final Judgment*, 552 F. Supp. at 172 n.172; Hillman, *supra* note 2, at 1187-93.

14. Ito, *supra* note 12, at 72.

15. *Id.*

16. *Id.*

17. *Id.*

18. The telegraph was introduced to Japan in 1869, when the private economy was in such disrepair that it could not have handled the telegraph system. *Id.* For a good discussion of the civil strife in Japan prior to the Meiji Restoration in 1868, see E. REISCHAUER & A. CRAIG, JAPAN: TRADITION AND TRANSFORMATION 116-44 (1978).

19. Ito, *supra* note 12, at 72.

20. *Id.*

21. *Id.*

22. The Ministry of Communications was created in 1885 to take over the telegraphs from the Ministry of Technology and mail service from the Ministry of Agriculture and Commerce. *Id.*

23. Eventually, the entire Allied occupation became known as SCAP.

the Japanese labor movement.<sup>24</sup> At first, SCAP encouraged the development of a labor movement, but became less enthusiastic when the movement began to attract Marxist influences.<sup>25</sup> The most radical elements eventually became concentrated in the government-owned businesses.<sup>26</sup> In 1947, the railroad industry was crippled by strikes, and the rehabilitation of the entire Japanese economy seemed in danger.<sup>27</sup> Also in 1947, the National Public Employees Act was enacted,<sup>28</sup> which prohibited government employees from striking.<sup>29</sup> The prohibition was extended to employees of *kosha* in 1948.<sup>30</sup> Thus, it applied to the telephone monopoly, which was also organized as a *kosha* in 1948.<sup>31</sup>

After the Occupation was over, the Japanese Diet (national legislature) established two government monopolies, Nippon Telephone and Telegraph Public Corporation ("NTT") for domestic service in 1952, and Kokusai Kenchin Denwa Co., Ltd. ("KDD") for international service in 1953,<sup>32</sup> and created the MPT to regulate them.<sup>33</sup> In addition to addressing MacArthur's labor concerns, the Diet wanted to inject efficiency and flexibility into telephone management<sup>34</sup> to rebuild a telephone network crippled by World War II.<sup>35</sup> The Diet also reaffirmed the commitment it made in 1890 to avoid wasteful duplication of facilities, achieve economies of scale, and develop nationwide telephone service.<sup>36</sup> Finally, the Japanese government felt it could use its control of the telephone system to promote other Japanese industries.<sup>37</sup>

During the 1960s and 1970s, the Japanese business community began to complain that the government-owned telecommunications monopoly could not respond to changes in technology quickly enough to satisfy its needs.<sup>38</sup> The MPT created a special Telecommunications Policy Division in response to these complaints.<sup>39</sup> However, this reform was not enough, and the Diet passed legislation privatizing NTT and opening up its telecommunications market to

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24. C. JOHNSON, JAPAN'S PUBLIC POLICY COMPANIES 29-30 (1978).

25. E. REISCHAUER & A. CRAIG, *supra* note 18, at 282-83; D. HALBERSTAM, THE RECKONING 111-30 (1986).

26. C. JOHNSON, *supra* note 24, at 29.

27. *Id.*

28. Kokka Komuin Ho ("National Public Employees Act"), Law No. 120 (1947).

29. See H. TANAKA, THE JAPANESE LEGAL SYSTEM 354 (1976).

30. Kokyo Kigyo-tai to Rodo Kankei Ho ("Labor Relations in Public Enterprises Act"), Law No. 257 (1948).

31. C. JOHNSON, *supra* note 24, at 29-30.

32. Ito, *supra* note 12, at 73; Comment, *supra* note 5, at 148 n.20. *Kokusai Denchin Denwa* translates roughly to "the second telephone company."

33. Ito, *supra* note 12, at 73.

34. *Id.*

35. Comment, *supra* note 5, at 149 n.24.

36. *Id.* at 148.

37. *Id.* at 149.

38. Ito, *supra* note 12, at 74; Note, *supra* note 5, at 501.

39. Ito, *supra* note 12, at 74; Note, *supra* note 5, at 501.

competition.<sup>40</sup> This was done for three reasons. First, nationwide service had already been established.<sup>41</sup> Second, the government felt that the public would be better served by private corporations subject to competition since competition would force prices down.<sup>42</sup> Third, the government felt that privatization would promote technological innovation and help Japanese firms compete worldwide.<sup>43</sup>

Prior to the enactment of the new telecommunications legislation, the Ministry of International Trade and Industry ("MITI") proposed alternative legislation. MITI wanted to exercise exclusive jurisdiction over the new enhanced services industry.<sup>44</sup> In essence, MITI wanted MPT jurisdiction to be limited to basic telephone service.<sup>45</sup> The MPT, however, did not want its jurisdiction to be limited. It wanted to control who was allowed to enter the industry, and wanted to exert the same kind of influence that MITI exerted on other parts of the economy.<sup>46</sup> The MPT may also have been motivated by the higher status associated with a *sesaku kancho*, or "policy agency," relative to *jigyo kancho*, or "business operating agency."<sup>47</sup> As a compromise, the MPT retained authority to regulate telecommunications and set interconnect standards,<sup>48</sup> but its power over market entry was limited.<sup>49</sup>

The new telecommunications legislation divides Japanese telecommunications companies into Type I and Type II companies.<sup>50</sup> Type I companies provide basic

40. See NTT Act, *supra* note 5.

41. Comment, *supra* note 5, at 163. In 1987, Japan had 46 million telephones serving 39 million households. *Nasty Calls by the Thousands*, London Times, Aug. 11, 1987, at 26, col. 4.

42. Comment, *supra* note 5, at 163.

43. *Id.*; Note, *supra* note 5, at 503-04.

44. Ito, *Telecommunications and Industrial Policies in Japan: Recent Developments*, in MARKETPLACE FOR TELECOMMUNICATIONS: REGULATION AND DEREGULATION IN INDUSTRIALIZED DEMOCRACIES 217 (M.S. Snow ed. 1986).

45. *Id.* at 219.

46. *Id.* at 220. MITI is the Japanese agency responsible for "industrial policy." There are two elements to MITI's industrial policy. The first is "industrial rationalization policy," in which MITI makes judgments on production technologies and methods in a particular industry, and forced the companies in that industry to adopt what MITI considers to be the best method. Occasionally, companies are forced out of business under this policy. The second element of MITI's industrial policy is "industrial structure policy," in which MITI forces investment away from what it considers declining industries, and into what MITI deems to be rising industries. C. JOHNSON, MITI AND THE JAPANESE MIRACLE 26-29 (1982).

As an example of industrial rationalization policy, Kazuo Yamanouchi uses a MITI requirement that all the farmers in a certain geographic area raise a certain breed of pig. Yamanouchi, *Administrative Guidance and the Rule of Law*, 7 LAW IN JAPAN SYSTEM 22-31 (1974), reprinted in H. TANAKA, THE JAPANESE LEGAL SYSTEM 390-91 (1976). As a part of its industrial structure policy in the 1970s, MITI ordered cartels to be formed in the textile, rubber, steel shipbuilding, and some petrochemical industries. Limits on market shares were placed on the companies in each industry, and each company was ordered to retrain or pension a certain number of employees. C. JOHNSON, *supra*, at 303. In 1965, MITI ordered the steel industry to reduce production. When one company refused, MITI cut its coal import quota. H. TANAKA, *supra* note 29, at 368-70.

47. Ito, *supra* note 44, at 219.

48. Telecommunications Act, *supra* note 5, § (7).

49. Ito, *supra* note 44, at 220.

50. Telecommunications Act, *supra* note 5, § (4).

telephone service through their own facilities.<sup>51</sup> Type II companies lease lines from Type I carriers, and provide "value-added" or "enhanced" service.<sup>52</sup> Type II companies are further subdivided into "special" companies, providing nationwide or international service, and "general" companies, which are all non-special companies.<sup>53</sup> All new Type I carriers need to be licensed by the MPT.<sup>54</sup> General Type II carriers must notify the MPT of their intent to provide service, and special Type II carriers must register with the MPT.<sup>55</sup> There are now five Type I carriers providing service, including NTT.<sup>56</sup> There are also four companies with Type I licenses which have not begun operating yet.<sup>57</sup> Another company, Satellite Japan, applied for a Type I license, but it was rejected in 1986.<sup>58</sup> There are now over 300 Type II carriers.<sup>59</sup>

Although these reforms are considered deregulation, the new legislation still provides MPT with a great deal of authority to mold the telecommunications industry to serve the public interest.<sup>60</sup>

### B. The United States

Since the invention of the telephone in 1876, AT&T has been the most significant telecommunications service provider in the United States.<sup>61</sup> For the first ten or fifteen years of its existence, AT&T's monopoly was protected by the patent laws.<sup>62</sup> However, from 1893 to about 1915, AT&T competed with other telephone companies.<sup>63</sup> Competition created: (1) inefficient duplication of facilities, (2) produced unreasonably high revenues for some carriers and inadequate revenues for others, (3) limited availability of service in remote, rural areas, and (4) created unreasonably high rates for consumers. Most states started regulating telephone service between 1915 and 1920 to correct these

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51. Ito, *supra* note 44, at 220.

52. Masuda, *supra* note 5, at 42; Comment, *supra* note 5, at 165.

The FCC defines a "value-added" or "enhanced" service as a service "which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information." 47 C.F.R. § 64.702(a)(1990). For more discussion of these services, see Comment, *supra* note 4.

53. Telecommunications Act, *supra* note 5, § (4); Masuda, *supra* note 5, at 42.

54. Telecommunications Act, *supra* note 5, § (5)1.

55. *Id.* § (6); Masuda, *supra* note 5, at 42; Comment, *supra* note 5, at 166.

56. *The Competitive Dawn Breaks in Japan*, TELEPHONY 66, 66 (L. Lannon ed. July 27, 1987) [hereinafter *Competitive Dawn*].

57. *Id.*

58. Comment, *supra* note 5, at 170.

59. *Competitive Dawn*, *supra* note 56, at 66; Okuyama, *supra* note 5, at 53.

60. Note, *supra* note 5, at 514-16.

61. See generally *Modified Final Judgment*, 552 F. Supp. at 131; Lavey, *The Public Policies That Changed the Telephone Industry Into Regulated Monopolies: Lessons From Around 1915*, 39 FED. COM. L.J. 171, 179 (1988).

62. Lavey, *supra* note 61, at 177.

63. *Id.*

problems.<sup>64</sup> Some regulators found that competition in a natural monopoly market was inefficient, and demanded that telephone service be provided by one company.<sup>65</sup> Furthermore, AT&T began to lobby for regulation in order to erect barriers to entry into the telephone market.<sup>66</sup> Unlike Japan, however, there is a traditional mistrust of government ownership of industry in the United States.<sup>67</sup> This mistrust is why the United States has never seriously considered nationalizing AT&T.<sup>68</sup>

The changes in the U.S. telecommunications industry that would eventually make competition possible began in the 1950s. At that time, telecommunications companies began using microwave radio technology to develop private communications networks for large industrial corporations.<sup>69</sup> AT&T often complained to the FCC that these private line networks would reduce its revenues in urban areas, and therefore make it more difficult to provide service to rural areas.<sup>70</sup> At the time, the FCC did not view this as a real threat, so it allowed companies to build these private line networks.<sup>71</sup> Nevertheless, these private line systems did eventually develop the capability to compete with AT&T.<sup>72</sup>

United States telecommunications regulations were reformed in 1982 when Judge Harold Greene, sitting in the Federal District Court of the District of Columbia, held that new developments in microwave and satellite technology

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64. See generally Lavey, *supra* note 61.

65. *Id.* at 179-80.

66. Robinson, *The Federal Communications Act: An Essay on Origins and Regulatory Purpose*, in A LEGISLATIVE HISTORY OF THE COMMUNICATIONS ACT OF 1934 3-8 (M. Paglin ed. 1989) [hereinafter Robinson].

67. W. BAUMOL & A. BLINDER, *supra* note 6, at 497.

68. The telephone industry was first placed under regulation under the Mann-Elkins Act, 34 Stat. 539, 545 (1910) (codified in scattered sections of 49 U.S.C.). The Mann-Elkins Act was intended to strengthen the ICC's authority over railroads and establish a separate "Commerce Court" to review ICC decisions. The Mann-Elkins Act was amended on the House floor to extend the ICC's jurisdiction to the telecommunications industry. Therefore, the decision to regulate telephones was almost an afterthought, and there was no discussion of substantive regulatory policy or whether to nationalize the industry. See 45 CONG. REC. 5533-37, 6972-77; Robinson, *supra* note 66, at 4-8.

When the FCC was created, the intent was to transfer the existing powers of the ICC to a new regulatory body. Robinson, *supra* note 66, at 4-8. No one in the Senate even suggested nationalizing AT&T. See S. REP. NO. 3285, 73d Cong., 2d Sess. (1934), reprinted in 4 THE ECONOMIC REGULATION OF BUSINESS AND INDUSTRY 2425 (B. Schwartz ed. 1973).

69. Hillman, *supra* note 2, at 1187-88.

70. This is often referred to as "cream-skimming."

71. See, e.g., Allocation of Microwave Frequencies Above 890 Mc., 27 F.C.C. 359 (1959), *aff'd on rehearing*, 29 F.C.C. 825 (1960); Microwave Communications, Inc., 18 F.C.C. 2d 953 (1969), *reh'g denied*, 21 F.C.C. 2d 190 (1970); Specialized Common Carrier Services, 29 F.C.C. 2d 870 (1971), *reh'g denied*, 31 F.C.C. 2d 1106 (1971), *aff'd sub nom.* Washington Utility and Transportation Comm'n v. FCC, 513 F.2d 1142 (9th Cir.), *cert. denied*, 423 U.S. 836 (1975).

72. MCI v. FCC, 561 F.2d 365 (D.C. Cir. 1977) ("*Execunet I*"); MCI v. FCC, 580 F.2d 590 (D.C. Cir. 1978) ("*Execunet II*"). For an overview of this evolution, see Hillman, *supra* note 2, at 1187-98.



eliminated the natural monopoly character of long distance service.<sup>73</sup> Therefore, Judge Greene required that AT&T divest itself of its local service companies.<sup>74</sup> Judge Green also reorganized the local service companies into seven regional holding companies ("RHCs") rather than one nationwide holding company.<sup>75</sup> The purpose of this reorganization was to remove the local service companies' incentive to act as a "bottleneck," or in other words, to control which long distance companies were provided with access to consumers.<sup>76</sup> The primary factor motivating these regulatory reforms was general antitrust law. The court wanted to promote competition to benefit consumers and other firms in the industry.<sup>77</sup>

A comparison at this stage reveals the divergent policies pursued by Japan and the United States in developing their telecommunications industries. While Japan sought to assist Japanese telecommunication firms competing in foreign markets, Judge Greene did not express any concerns over promoting foreign competition.<sup>78</sup> Also unlike Japan, Judge Greene did not place any restrictions on entry into the telecommunications market.<sup>79</sup> The Japanese government retained authority to control the telecommunications market, while the United States placed its emphasis on limiting AT&T's ability to control the market, and did not place any other restrictions on the operation of market forces.

### III. COMMON REGULATORY PROBLEMS

#### *A. Control Over Pricing*

1. *Japan.* When NTT was a government monopoly, it had authority to set its own prices, even though its budget had to be approved by the MPT, the Cabinet, and the Diet.<sup>80</sup> Now NTT is a regulated company, but it still sets its own prices. The MPT, however, oversees NTT's prices to ensure that they are not set so low that other carriers are deterred from entering the market.<sup>81</sup>

The MPT has never developed any guidelines for setting prices.<sup>82</sup> Instead, the

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73. *Modified Final Judgment*, 552 F. Supp. at 160-63. Judge Greene retained jurisdiction over the administration of the *MFJ*, and therefore exercises great power over the regulation of the United States telephone system. *Id.* at 231.

74. *Id.* at 160-70.

75. *Id.* at 161.

76. *Id.* For more on the access issue and bottleneck facilities, see notes 119-20, *infra*.

77. *Id.* at 149-51.

78. *See generally id.* In the case, AT&T asserted that the divestiture would limit its ability to innovate. Although the Court recognized that a reduction in innovation would not be in the "public interest," it eventually rejected AT&T's claims as unfounded. *Id.* at 147-49.

79. *See generally id.*

80. Comment, *supra* note 5, at 150.

81. *See NTT Act*, *supra* note 5, § (4). *See also Competitive Dawn*, *supra* note 56, at 70; Doe, *Japan's \$20 Billion Telecom Giant at the Crossroads*, ELECTRONIC BUS. 132 (Oct. 1, 1985). *See generally Meet Japan's Telecom Giant: NTT's Dr. Hisashi Shinto*, TELEPHONY 32 (May 25, 1987) (Interview with President and Chief Executive Officer of NTT).

82. Doe, *supra* note 81, at 132.

MPT exercises control over NTT's prices by a process commonly employed in other areas of Japanese administrative law known as *gyosei shido* ("administrative guidance"). Administrative guidance is an administrative agency's request that a corporation voluntarily comply with the agency's wishes, whether or not the agency has statutory authority to make the request.<sup>83</sup> One Japanese legal scholar asserts that these suggestions carry weight because Japanese society has historically adopted an attitude of *kanson mimpi*, or "respect the officials and downgrade the people."<sup>84</sup> Therefore, these suggestions can carry as much force as an application of public authority, even though compliance is nominally voluntary.<sup>85</sup>

The agency usually has a definite plan for the organization and future of an industry, and through administrative guidance, it requests businessmen, orally or in writing, to conduct themselves in conformity with this plan.<sup>86</sup> However, unlike agencies in the United States, Japanese agencies are usually not required to make this plan public<sup>87</sup> "[because] many of the activities are conducted informally and because the government offices concerned do not like to clarify their contents, it is difficult to grasp them clearly."<sup>88</sup>

In the case of telecommunications, the MPT seems to be actively promoting the development of a market in which several companies compete with NTT.<sup>89</sup> In other words, the MPT has retained the power to shape the telecommunications market in ways it considers beneficial.

2. *The United States.* In contrast to Japan's pricing policies, which give the MPT a great deal of discretion, the procedures for setting prices in the United States are specifically prescribed by statute.<sup>90</sup> The traditional method of regulation is called "rate of return" regulation.<sup>91</sup> Under rate of return regulation, the telephone company is guaranteed a fair rate of return on its investment.<sup>92</sup> Specifically, the telephone company is guaranteed the recoupment of its investment in equipment used and useful in the provision of telephone service, plus a just and reasonable rate of return, and all reasonably incurred

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83. Narita, *Administrative Guidance*, 2 LAW IN JAPAN 45 (1968), reprinted in H. TANAKA, THE JAPANESE LEGAL SYSTEM 354 (1976). For more on administrative guidance, see C. JOHNSON, *supra* note 46, at 242-74.

84. H. TANAKA, *supra* note 29, at 356.

85. *Id.*

86. *Id.* at 365.

87. See, e.g., *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402 (1971); *SEC v. Chenery Corp.*, 332 U.S. 194 (1947).

88. H. TANAKA, *supra* note 29, at 364.

89. *Competitive Dawn*, *supra* note 56, at 70; Doe, *supra* note 81, at 132; Comment, *supra* note 5, at 175; Okuyama, *Deregulation Widely Affects Telecommunications*, BUSINESS JAPAN 55, 55 (Aug. 1988).

90. Communications Act, 47 U.S.C. §§ 201-204 (1988 & Supp. 1990).

91. J. BONBRIGHT, *supra* note 7; L. SCHWARTZ, J. FLYNN, & H. FIRST, *supra* note 9, at 316.

92. The company is guaranteed a fair rate of return because the Supreme Court determined that setting rates so that the company could not earn a fair return was confiscatory in violation of the Fifth Amendment. *Smyth v. Ames*, 169 U.S. 466, 526 (1898).

expenses.<sup>93</sup>

Recently, the FCC has developed an alternative to rate of return regulation called Price Cap regulation.<sup>94</sup> Rather than setting limits on a carrier's rate of return, Price Caps set limits on prices themselves.<sup>95</sup> The caps increase with the inflation rate minus three percent.<sup>96</sup> The carrier is allowed to set its rates five percent above or below present rates, as long as the weighted average of all its rates does not exceed the applicable Price Cap.<sup>97</sup>

Within the context of this complex formula for determining telephone rates, the Communications Act of 1934 specifies the pricing procedures the FCC and telephone companies must follow. When the telephone company asks for a rate increase, the FCC has ninety days to determine whether these rates are "just and reasonable."<sup>98</sup> The FCC can accept or reject these rates,<sup>99</sup> initiate an investigation into the reasonableness of the rates,<sup>100</sup> or prescribe a rate of its own.<sup>101</sup> If the FCC initiates an investigation and fails to make a ruling within five months, the new rate goes into effect.<sup>102</sup>

In sum, the MPT has great latitude to promote competition in the Japanese telecommunications market, while the FCC has limited its regulatory oversight in an effort to release competitive forces in the United States market. While the Japanese government maintains an active role in the economy, the United States government views its role as one that removes impediments to competition, and nothing more.

### B. Cross-Subsidization

1. *Japan.* Cross-subsidization occurs when a communications common carrier charges excessive prices on some services in order to charge below-cost prices on

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93. During the first half of the twentieth century, much judicial energy was expended over the proper way to determine whether rates are "just and reasonable." See generally L. SCHWARTZ, J. FLYNN, & H. FIRST, *supra* note 9, at 363-409. In 1944, the United States Supreme Court settled this issue in the *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). In *Hope*, the Court developed the "zone of reasonableness" test which stated that as long as the rates were high enough to attract capital, but not so high as to be unfair to consumers, the rates were just and reasonable. *Id.* at 602-05.

94. Policy and Rules Concerning Rates for Dominant Common Carriers, 4 F.C.C. Rcd. 2783 (1989) ("Price Cap Order"). For an excellent discussion of Price Caps, see J. HILLMAN & R. BRAEUTIGAM, *PRICE LEVEL REGULATION FOR DIVERSIFIED PUBLIC UTILITIES* (1989).

95. Price Cap Order, 4 F.C.C. Rcd. at 2893.

96. *Id.* at 2972-74. The Price Cap is set three percent less than the inflation rate because the Commission found that the telecommunications industry has been an average of 2.5% more productive than the economy as a whole, and expected telecommunications productivity to increase an additional 0.5% in the future. *Id.* at 2994-96.

97. *Id.* at 3065-67.

98. Communications Act of 1934, 47 U.S.C. § 203 (1988).

99. *Id.* § 204.

100. *Id.*

101. *Id.* § 205.

102. *Id.* § 204.

other services.<sup>103</sup> Prior to 1985, NTT had always engaged in some form of cross-subsidization charging excessive rates on long distance and equipment installation fees to keep local telephone service rates low.<sup>104</sup>

After April 1, 1985, this cross-subsidization was reduced because competition in the equipment market forced NTT to lower its equipment prices.<sup>105</sup> Since cross-subsidization requires excessive rates to be charged for some services, competition in the equipment market has made it harder for NTT to charge higher rates. However, through administrative guidance,<sup>106</sup> the MPT has informally prevented NTT from reducing cross-subsidization too much.<sup>107</sup> MPT has requested NTT not to reduce its equipment fees below those charged by other Type I carriers.<sup>108</sup> The MPT did this to keep local telephone rates low, and to protect new Type I carriers from being driven out of the market by NTT.<sup>109</sup> So far, NTT has cooperated with the MPT to achieve this goal.<sup>110</sup>

2. *United States.* Before the divestiture, AT&T cross-subsidized local rates with long distance revenues.<sup>111</sup> This is no longer possible, because after the divestiture, local and long distance service are provided by different companies. The "access fee" that long distance carriers are required to pay to Local Exchange Carriers ("LECs") tend to have the same effect.<sup>112</sup> Originally, this fee was a flat \$2.00 per customer,<sup>113</sup> but now access fees are determined by the rate of return method applied to three accounting categories of access investment.<sup>114</sup>

The FCC, however, has prohibited AT&T from cross-subsidizing equipment revenues since the early 1970s.<sup>115</sup> Under the "Maximum Separations" policy,

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103. See Comment, *supra* note 4, at 416.

104. Comment, *supra* note 5, at 151-52.

105. *Id.* at 174.

106. See *supra* notes 83-84 and accompanying text.

107. *Competitive Dawn*, *supra* note 56, at 70-71; Doe, *supra* note 81, at 132.

108. *Competitive Dawn*, *supra* note 56, at 70-71.

109. *Id.*

110. *Id.* at 70. However, competition from other carriers may be eroding NTT's willingness to be cooperative. Norris, *Behind the Slump in N.T.T. Shares*, N.Y. Times, Mar. 27, 1989, at 28, col. 1.

111. Hillman, *supra* note 2, 1214-20.

112. *Id.* at 1217-18.

113. National Ass'n of Reg. Util. Comm'rs v. FCC, 737 F.2d 1095, 1122 (D.C. Cir. 1984).

114. See 47 C.F.R. §§ 69.1-69.612 (1990). As discussed above, the telephone company is guaranteed the recoupment of its investment in equipment used in providing telephone service, plus a just and reasonable rate of return, and all reasonably incurred expenses. See *supra* text accompanying notes 90-93. The three accounting categories are Special Access, Common Line, and Switched Traffic Sensitive. Special Access is made up mostly of investment on telephone lines connecting end users directly to interexchange users. Common Line is investment in facilities connecting end users or interexchange carriers to the local exchange network. Finally, Switched Traffic Sensitive rates recover the costs of equipment which vary with use. See 47 C.F.R. § 65.702(b). More specifications for setting prices are established in Part 69 of the FCC's rules. See 47 C.F.R. §§ 69.4(b), 69.101-69.115.

115. Regulatory & Policy Problems Presented by the Interdependence of Computer & Communications Services & Facilities, Tentative Decision, 28 F.C.C.2d 291(1970) ("*Computer I, Tentative Decision*"), modified, Final Decision, 28 F.C.C.2d 267(1971) ("*Computer I, Final Decision*"), *aff'd in part sub nom.* GTE Service Corp v. FCC, 474 F.2d 724 (2d Cir. 1973). *Computer I* was

carriers could offer customer premises equipment ("CPE") only through a separate subsidiary. The subsidiary is required to have separate officers and operating personnel, and all business transactions between the parent and the subsidiary are to be reported to the FCC.<sup>116</sup> The FCC designed these rules to prevent cross-subsidization in the other direction, i.e., to prevent overcharging captive local service users and predatory pricing in the competitive equipment market.<sup>117</sup> The *MFJ* court reaffirmed these rules, and applied them to the RHCs, but allowed them to market equipment manufactured by others.<sup>118</sup>

Again, rather than merely intervening directly in the decisions of businesses to make adjustments as the Japanese MPT has done, the FCC has established specific and detailed rules to regulate the telecommunications market.

### C. Access to Consumers

1. *United States.* One of the most contentious telecommunications issues in both the United States and Japan is consumer access. Because of the advances in technology involving microwave transmissions and satellites, it is no longer necessary to have wires strung from city to city to connect long distance calls. When there is no longer a need for wires, long distance service loses its natural monopoly characteristics. Consequently, long distance service can be provided in a competitive market.<sup>119</sup> However, wires are still required to provide local telephone service. Thus, if one company provides both local and long distance service, it has an incentive to arrange its local facilities in such a way that no other long distance carriers can provide their service to consumers.<sup>120</sup> Accordingly, the local network is often referred to as a "bottleneck" facility.

In order to prevent the abuse of bottleneck facilities, the *MFJ* prohibits RHCs from engaging in many kinds of businesses<sup>121</sup> such as the manufacture of telecommunications products,<sup>122</sup> information services,<sup>123</sup> CPE,<sup>124</sup> and advertising directories.<sup>125</sup> Most importantly, the *MFJ* prohibits the RHCs from

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modified in later years, but its rules covering equipment have not been affected. See *Second Computer Inquiry*, 77 F.C.C.2d 384 (1980), *modified on reconsideration*, 84 F.C.C.2d 50 (1980), *further modified on reconsideration*, 88 F.C.C.2d 512 (1981) *aff'd sub nom.* *Computer and Communication Indus. Ass'n v. FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983) ("*Computer II*"); *Third Computer Inquiry, Report and Order*, 104 F.C.C.2d 958 (1986), *rev'd and remanded in part*, *California v. FCC*, 905 F.2d 1217 (9th Cir. 1990) ("*Computer III Order*").

116. *Computer I, Final Decision*, 28 F.C.C.2d at 303-04.

117. *Id.* See generally Comment, *supra* note 4, at 419-20.

118. *Modified Final Judgment*, 552 F. Supp. at 186. For more on the maximum separation rules, see Comment, *supra* note 4, at 419-20.

119. *Modified Final Judgment*, 552 F. Supp. at 160-63; Hillman, *supra* note 2, at 1215.

120. Comment, *supra* note 4, at 417.

121. *Modified Final Judgment*, 552 F. Supp. at 185-90.

122. *Id.* at 190-91.

123. *Id.* at 189-90.

124. *Id.* at 190-91.

125. *Id.* at 193-94.

providing long distance service.<sup>126</sup> The *MFJ* court promised to review the industry every three years to determine if these "line of business" restrictions were still necessary to protect competition.<sup>127</sup> At the first review, all seven RHCs petitioned the court to relax these restrictions, but the court refused.<sup>128</sup>

2. *Japan*. In 1987, Japan faced a major consumer access dispute.<sup>129</sup> The dispute was over establishing a third trans-Pacific cable providing international telephone service between Japan and the United States to compete with KDD.<sup>130</sup> Two consortiums were interested in developing the third cable. One was led by Matsushita Electric Industrial Company and Mitsubishi Corporation, and was made up completely of Japanese companies.<sup>131</sup> The other was led by Cable and Wireless PLC of Great Britain, C. Itoh of Japan, and Pacific Telesis of the United States, and was made up of several companies from the United States, Japan, and Europe.<sup>132</sup> Since MPT felt that the international market was not large enough to support four cables,<sup>133</sup> it suggested that the two consortiums merge<sup>134</sup> and limit the share for each Japanese company to 5% and foreign companies to 3%.<sup>135</sup> Both the United States<sup>136</sup> and Great Britain<sup>137</sup> interpreted this proposal as protectionistic.<sup>138</sup> The all-Japanese consortium wanted to share KDD's cable. But, the Cable and Wireless consortium argued that this would hinder the development of real competition<sup>139</sup>—if other competitors were required to use KDD's cable, KDD could use its cable as a bottleneck facility to restrict its competitors' access to consumers.

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126. *Id.* at 188-89. The country is divided into approximately 200 local access and transport areas ("LATA"). The RHCs are not allowed to provide service across LATA boundaries.

127. *Id.* at 194-95.

128. *United States v. Western Electric Co.*, 673 F. Supp. 525 (D.D.C. 1987). Later the court reaffirmed other line-of-business restrictions, but relaxed the prohibition against information services, allowing the RHCs to transmit information generated by others but not to generate it themselves in *Western Electric*, 1988-1 Trade Cas. (CCH) ¶ 67, 918 (D.C. Cir. 1988). This was overturned by the Court of Appeals in *United States v. Western Electric Co.*, 900 F.2d 283 (D.C. Cir. 1990).

129. The press covered this dispute rather heavily, although it focused on the foreign trade aspects of the issues.

130. The second trans-Pacific cable was a fiber-optic cable. AT&T and KDD agreed to enter into a joint venture to lay this cable in early 1987. *AT&T, Japanese Firm Discuss Constructing Pacific Phone Line*, Wall St. J., Apr. 23, 1987, at 51, col. 2. This was completed in April 1989. Sims, *Fiber-Optic Calling to Japan Starts Today*, N.Y. Times, Apr. 18, 1989, at 33, col. 3.

131. Roberts, *Pacific Telesis Joins Bid to Build Japan-U.S. Link*, Wall St. J., Mar. 4, 1987, at 5, col. 1.

132. *Id.*

133. Lachica, *Japan Bars Wider Foreign Participation in Venture on Telecommunications Link*, Wall St. J., Mar. 31, 1987, at 5, col. 1.

134. *Id.*

135. Marcom, *As Britain Inches Toward Retaliation, Japan Alters Telecommunications Offer*, Wall St. J., Apr. 3, 1987, at 27, col. 4.

136. Lachica, *supra* note 133, at 5, col. 1.

137. Marcom, *supra* note 135, at 27, col. 4.

138. *Id.*

139. Darlin, *Cable & Wireless Proposal May Force Trade Dispute With Japan to a Head*, Wall St. J., July 28, 1987, at 29, col. 5.

The Cable and Wireless consortium proposed an alternative merger plan, in which four companies from each consortium would hold 72% of the new consortium, of which non-Japanese companies would hold 33%.<sup>140</sup> However, when the all-Japanese consortium rejected this proposal,<sup>141</sup> the Japanese government agreed to grant licenses to both consortiums in order to avoid trade disputes with Great Britain and the United States.<sup>142</sup> The new trans-Pacific cable is expected to be completed by 1990.<sup>143</sup>

As the above discussion illustrates, there is a sharp contrast in the way Japan and the United States handled recent consumer access disputes. While the FCC established rules designed to lead to equal access without direct government intervention in the market, the MPT tried to push telecommunications companies to a negotiated access arrangement.

#### CONCLUSION

A comparison of the way the United States and Japan deal with regulatory problems provides an interesting insight into their cultures as a whole, and leads to several conclusions. First, people in the United States prefer to have their rights and responsibilities explicitly defined, while the Japanese assume that they are aware of their responsibilities and that an explicit definition is unnecessary. Second, Japan places a higher premium on cooperation and harmony than does the United States. Third, Japan views its government as a force for good, while Americans tend to view their government as a necessary evil.

Thus, the Japanese are much more reluctant than Americans to establish a very detailed regulatory system. Also, the Japanese assume that everyone knows, understands, and accepts their place in society, while Americans prefer to have expectations spelled out explicitly. This is probably due to the heavy influence of Confucianism<sup>144</sup> and to the high level of ethnic homogeneity which shapes the Japanese attitude.<sup>145</sup>

This cultural dichotomy is reflected in the very informal way the MPT oversees NTT pricing, and the detailed manner in which the FCC oversees AT&T pricing.<sup>146</sup> This is also reflected in the continued effectiveness of the administrative guidance system in the area of cross-subsidization.<sup>147</sup> NTT cooperates with the MPT in not competing all-out with other Type I carriers, even though

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140. *Id.*

141. *Talks Fail Between Cable & Wireless, Japanese Group*, Wall St. J., Aug. 5, 1987, at 19, col. 2.

142. *Cable & Wireless Venture Gets Japan Phone License*, Wall St. J., Dec. 1, 1987, at 33, col. 4.

143. Sims, *supra* note 130, at 33, col. 3.

144. R. CHRISTOPHER, *THE JAPANESE MIND* 46-47 (1983); R. SMITH, *JAPANESE SOCIETY: TRADITION, SELF AND THE SOCIAL ORDER* 31-33 (1983); E. REISCHAUER, *THE JAPANESE* 213-14 (1977); E. REISCHAUER & A. CRAIG, *supra* note 18, at 92-94.

145. E. REISCHAUER, *supra* note 144, at 413; E. REISCHAUER & A. CRAIG, *supra* note 18, at 3.

146. *See Doe*, *supra* note 81, at 132.

147. *See supra* notes 75-82 and accompanying text.

it is not under any legal compunction to do so.<sup>148</sup> However, when the FCC wants to influence AT&T's behavior, it must promulgate rules in compliance with the Communications Act of 1934<sup>149</sup> and the Administrative Procedure Act.<sup>150</sup>

Another cultural aspect which influences telecommunications regulation is that Japan places a higher premium than the United States on cooperation and harmony. Accordingly, the Japanese government encouraged the Cable and Wireless consortium and the all-Japanese consortium to merge so it could avoid rejecting either application. The government awarded both licenses, even though it did not believe the market could support that much competition.<sup>151</sup>

Finally, the Japanese people tend to view government as a force for good, and therefore, the government is given broad power to promote the proper development of the economy and the proper formation of the social order.<sup>152</sup> In contrast, Americans tend to view government as an entity that only has the limited authority to create an environment in which individuals can freely pursue their economic interests.<sup>153</sup> Thus, AT&T was left unregulated until the government recognized the problems created by an unregulated telecommunications industry.<sup>154</sup> On the other hand, the Japanese government owned NTT from 1952 to 1985, and only gave up ownership when it became clear that the private sector could run NTT better.<sup>155</sup>

Perceptions of the proper role of government have also influenced the method each nation used to reform their telecommunications regulations. Japan chose to reform its regulations through legislation, rather than through application of its general antimonopoly law as was done in the United States.<sup>156</sup> Japan probably made this choice because NTT and KDD, as government monopolies, were exempt from the antimonopoly laws.<sup>157</sup> The effect of this difference, in fora, was to reinforce the active government role in Japan and increase the passive government role in the United States. The purpose of the divestiture in the United States was to restrain AT&T so that other telephone companies could develop and compete.<sup>158</sup> On the other hand, the Japanese reforms give

148. *Competitive Dawn*, *supra* note 56, at 70.

149. 47 U.S.C. §§ 151-163 (1988 & Supp. 1990)

150. Administrative Procedure Act of 1946, ch. 324, 60 Stat. 237 (codified as amended in scattered sections of 5 U.S.C.).

151. Lachica, *supra* note 133, at 5.

152. See H. TANAKA, *supra* note 29, at 354.

153. *Id.* at 359.

154. Lavey, *supra* note 61, at 184-90.

155. Comment, *supra* note 5, at 162-63.

156. *Modified Final Judgment*, 552 F. Supp. at 149-51.

157. "The provisions of this Act shall not apply to such acts relating to the production, sale, or supply as are done in the proper course of business by a person engaging in a railway, electricity, gas or any other enterprise constituting a monopoly by the nature of the said business." Antimonopoly Act (Law No. 54, 1947) § (21), translated in H. IYORI & A. UESUGI, *THE ANTIMONOPOLY LAWS OF JAPAN* 111 (1983).

158. *Modified Final Judgment*, 552 F. Supp. at 150.



the MPT broad discretion to guide and structure the telecommunications industry.<sup>159</sup>

It is still too early to tell if the Japanese reforms will produce better or worse results than the reforms in the United States.<sup>160</sup> Some commentators are recommending that the United States government follow the Japanese model and provide guidance for the telecommunications industry.<sup>161</sup> Yet other commentators are suggesting that Japan implement a more rigid, United States-style industrial policy.<sup>162</sup> However, if Japan's history provides any foresight, it is very possible that Japanese telecommunications firms soon will be very competitive in the world markets.<sup>163</sup> However, this competitiveness will come at the price of heavy governmental involvement in private business, a level of involvement many in the United States would find intolerable. When people in the United States envy the success of Japanese businesses, they should keep this in mind.

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159. NTT Act, *supra* note 5, § (4); MARKETPLACE FOR TELECOMMUNICATIONS, *supra* note 44, at 224.

160. Okuyama, *supra* note 5, at 53.

161. Weisman, *The Proliferation of Private Networks and Its Implications For Regulatory Reform*, 41 FED. COM. L.J. 331, 360 (1989).

162. Hiatt, *A Lesson in Industrial Policy From Japanese Ministry?*, Washington Post, Dec. 12, 1989, at C1, col. 2.

163. See generally C. JOHNSON, *supra* note 46; D. HALBERSTAM, *supra* note 25 (successfulness of the Japanese automobile industry).